BTI 2008 | Serbia Country Report

Status Index	1-10	**7.20**	**#** 31 of 125	
Democracy	1-10	7.75	# 29 of 125	➔
Market Economy	1-10	6.64	# 40 of 125	➔
Management Index	1-10	**5.43**	**#** 50 of 125	
	scale: 1 (lowest) to 10 (highest)	score	rank	trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	**8.1**	HDI	**-**	GDP p.c.	$	**-**
Pop. growth[1]	% p.a.	**-0.3**	HDI rank of 177	**-**	Gini Index		**30.0**
Life expectancy	years	**73**	UN Education Index	**-**	Poverty[3]	%	**-**
Urban population	%	**52.2**	Gender equality[2]	**-**	Aid per capita	$	**138.5**

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. All data for Serbia and Montenegro. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than $2 a day.

Executive Summary

This analysis focuses largely on Serbia; Kosovo is discussed only where necessary. In the period between January 2005 and January 2007, Serbia experienced the dissolution of its State Union with Montenegro, new parliamentary elections, the adoption of a new constitution, a U.N. proposal for a supervised independence of Kosovo, and the suspension of negotiations with the European Union. These events shaped the country's trajectory of democratic and economic development. Until 2006, the Republic of Serbia, together with the Republic of Montenegro, had constituted a loosely integrated State Union that had been mediated by the European Union in 2003 to follow the Federal Republic of Yugoslavia. Having sought to establish an independent state from the inception of the State Union, Montenegro's government at last achieved a narrow popular majority for independence in a referendum held on 21 May 2006. Following Montenegro's proclamation of independence, Serbia declared itself as the successor state of the State Union and recognized Montenegro in June 2006. Both republics have settled the issues arising from the dissolution of the State Union in a cooperative spirit and in accordance with the State Union Constitutional Charter. After years of preparations, a new constitution was adopted by parliament on 30 September and approved by a referendum on 28 – 29 October 2006. The new constitution establishes a parliamentary system of government with a weak but directly elected president, defines a comprehensive catalogue of fundamental rights and contains numerous other improvements reflecting European and democratic standards. Parliamentary elections were held on 21 January 2007 in accordance with the requirements of the new constitution. Although the Serbian Radical Party emerged as the strongest party, parties defining themselves as "pro-European" won a majority of seats. This balance of interests enabled the formation of a government committed to sustaining democratic and economic reforms. In February 2006, negotiations on the final status of Kosovo commenced between the Serbian government and Kosovo

Albanian political representatives. Since the end of the Kosovo war, Serbia's former autonomous province has been governed by an interim administration of the United Nations. Whereas Kosovo Albanians want to create an independent state, the Serbian government advocates a territorial autonomy for Kosovo within Serbia. As the two sides failed to attain an agreement, the U.N. Special Envoy mediating the talks, Martti Ahtisaari, prepared a proposal for a Kosovo status settlement that laid the foundation for an independent Kosovo under international supervision. Serbia's attempts to become a member of the European Union were interrupted on 3 May 2006, when the European Union suspended negotiations on a Stabilization and Association Agreement, criticizing the Serbian government for its lack of will to cooperate with the International Criminal Tribunal for former Yugoslavia (ICTY). The government had not seized and extradited six ICTY indictees accused of war crimes committed during the wars following the breakup of Yugoslavia.

History and Characteristics of Transformation

The toleration and emergence of political pluralism in the Socialist Federative Republic of Yugoslavia and its six constituent republics brought political elites into power that instrumentalized nationalist ideologies and stereotypes to advance their nation-state projects. Led by Slobodan Milosevic, Serbia's state socialist party won the first democratic elections in 1990 and sought to retain its political power by re-establishing a centralized federation and blocking economic reform. The political leaders of the republics of Slovenia and Croatia wanted to advance the decentralization and the confederal reorganization of the federation, partly in the interest of facilitating market transition and liberalization, partly to facilitate their exit from the federation. Irreconcilable aims and nationalist mobilization led to the collapse of the federation and the emergence of Bosnia and Herzegovina, Croatia, Macedonia and Slovenia as independent states. In Bosnia and Herzegovina, Croatia and Slovenia, wars of different duration and intensity began when the Yugoslav National Army attacked the republics, assisting the rebellions of ethnic Serb communities in Bosnia and Croatia against the secessionists.

Facilitated by the wars and nationalist mobilization, Serbia's President Milosevic was able to establish a semi-authoritarian system in the remaining parts of Yugoslavia that kept him in power until 2000. His regime was based on clientelist networks in the state administration, police, military and the state-dominated economy, which allowed him control over the electronic media and gave him the power to forge the elections and to effectively fragment and isolate the political opposition. Responding to its deepening integration and legitimation crisis, the regime increased political repression in Serbia proper and the violent military repression of ethnic Albanians in Kosovo; the country then slid into a full-scale war. NATO air strikes forced the regime to abandon its

control over Kosovo and contributed to the demise of Milosevic. However, the democratic breakthrough in October 2000 was driven primarily by the united opposition and student protest movement and the electorate's growing discontent with the worsening economic and social situation.

The Democratic Opposition of Serbia (DOS), a coalition of 18 liberal social democrat and moderate nationalist parties, won the federal parliamentary and presidential elections as well as the Serbian local and parliamentary elections in 2000. The opposition leaders Vojislav Kostunica and Zoran Djindjic became federal president and Serbian prime minister, respectively. Once the governing coalition had achieved its main aim, the overthrow of the Milosevic regime, internal tensions grew over fundamental policy choices. The heterogeneity of the coalition and the assassination of Prime Minister Djindjic in March 2003 limited the government's capacity to sustain its initially dynamic policy of economic and political reform. The breakup of the governing coalition necessitated elections in December 2003 that led to the formation of a four-party coalition government headed by Kostunica.

The state framework of Serbia has changed several times since the dissolution of communist Yugoslavia. Between 1992 and 2003, Serbia and Montenegro, the two remaining republics of the former Yugoslavia, constituted republics of the Federal Republic of Yugoslavia. In 2003, Serbia and Montenegro replaced this state by a more loosely integrated State Union mediated by the European Union. The main aims of this Union were the accession to the European Union and the creation of an internal market in accordance with EU principles and standards. The State Union's powers were essentially limited to the enforcement of international law and cooperation with international courts, military issues and defense, and standardization, intellectual property rights, statistics, borders, asylum and immigration and visa issues. Following a referendum in May 2006, Montenegro became an independent state and the State Union was dissolved. As a consequence of its military defeat in the Kosovo war, Serbia had to accept a U.N.-led interim administration in Kosovo. While this administration has exercised political authority over the territory since 1999, based upon Resolution No. 1244/1999 of the U.N. Security Council, Kosovo de jure continues to belong to Serbia, the successor state of the State Union. Most Kosovo Albanians refuse to become citizens of Serbia due to their experience of violent repression and expulsion under the Milosevic regime. The Kosovo conflict continues to burden the consolidation of a market-based democracy in Serbia and the country's path toward membership in the European Union.

Transformation Status

I. Democracy

1 | Stateness

Monopoly on the use of force

The state's monopoly on the use of force is not contested in those parts of Serbia where Serbia has full, internationally recognized sovereignty. The Serbian government, parliament and president control the national administration, armed forces, judiciary and police. In Serbia's formerly autonomous province of Kosovo and Metohija, the monopoly on the use of force is exercised by an interim administration headed by the United Nations and backed by a multinational military force – the NATO Kosovo Force. The status of Kosovo is regulated by U.N. Security Council Resolution No. 1244.

State identity

Kosovo Albanians who constitute the largest non-Serb ethnic community on the territory of Serbia, refuse to accept Serbia's claim of authority over Kosovo and do not perceive themselves as part of the nation-state. In contrast, the Serbian government continues to view Kosovo Albanians as citizens of Serbia who belong to a national minority. Outside Kosovo, 17% of Serbia's citizens identified themselves as belonging to national minorities in the population census of 2002. National minorities include ethnic, linguistic and religious minorities who live predominantly in Vojvodina, Sandzak and southern Serbia. The situation of these groups has improved in the review period. There have been fewer attacks on persons belonging to national minorities in multi-ethnic Vojvodina. In Sandjak, the minority Bosniak communities experienced several incidents of inter-ethnic violence and hate speech. No incidents of violence have been reported from the ethnic Albanian community in Southern Serbia. In January 2006, ethnic Albanian parties from this area called for a comprehensive political and territorial autonomy and special institutional links with Kosovo. The legal protection of national minorities has been strengthened by a number of measures: the 2002 Federal Law on the Protection of Rights and Freedoms of National Minorities has been transposed into the legal order of Serbia, a draft law on national representative councils of national minorities has been prepared and the European Charter on Regional and Minority Languages was ratified in December

2005. The abolishing of the 5% threshold for political parties representing national minorities allowed these parties to re-enter parliament in January 2007.While the dissolved State Union Ministry for National Minorities was not re-established in Serbia, minorities are represented in a Republican Council for National Minorities chaired by the prime minister. Representatives of national minorities criticized the new Constitution for defining the Republic of Serbia as a state of Serbian people and all citizens who live in it, which would imply an ethnic concept of the nation-state, marking a departure from the exclusive reference to citizens in the previous constitution. Due to the wars, 106,700 refugees and 207,900 internally displaced persons reside under difficult socioeconomic conditions in Serbia. These people are granted citizen-ship rights and a majority of them intends to stay in Serbia. Their migration has shifted the fragile inter-ethnic balance in Vojvodina towards a preponderance of ethnic Serbs.

No interference of religious dogmas

Serbia is defined as a secular order. Religious dogmas have no noteworthy influence on politics or the law. However, the Serb Orthodox Church has a dominant role in religious, social and political life. While the new Law on Churches and Religious Communities adopted in April 2006 has strengthened the autonomy and legal status of religious communities, critics have argued that the Serbian Orthodox Church enjoys certain privileges.

Basic administration

The Republic of Serbia has a differentiated administration that extracts and allocates state resources throughout the country, albeit with limited efficiency.

2 | Political Participation

Free and fair elections

The parliamentary elections in January 2007 were free and fair, meeting the standards established by the Organization for Security and Cooperation in Europe and the Council of Europe. The media provided a balanced coverage of all parties and positions, the voting was organized peacefully and professionally, and the turnout reached 61%. In 2004, the electoral law had been amended to ensure a better representation of national minorities and women. As a consequence, political parties representing national minorities won eight mandates (3.2%) and the share of female deputies increased to 20%.The electoral legislation, however, constrains the ability of citizens to choose their candidates by allowing parties to arbitrarily distribute mandates among the candidates on their lists after the elections. This provision was intended to eschew practices of vote-buying and deals over changing of party caucus. To discipline deputies, Article 102 of the newly adopted constitution stipulates that “a deputy shall be free to irrevocably put his/her term of office at the disposal of the political party upon which proposal he or she has been elected a deputy.” The new provision has provided a constitutional basis for the parties’ practice of forcing their designated deputies to

sign blank resignations prior to entering parliament. The party leadership uses such resignations to strip disloyal deputies of their mandates. In addition, the persistent lack of a centralized voter register contributed to inaccuracies in voter lists, and the electoral law does not ensure sufficiently transparent rules and practices of campaign financing. In contrast to Kosovo Serbs, Kosovo Albanian voters were erased from the register of voters, although Kosovo Albanians continued to be officially classified as citizens of Serbia. The government justified this disenfranchisement on ethnic grounds as necessary to attain the minimum turnout required for the adoption of the constitution in 2006 and the election of a new president in 2004. Kosovo Albanians used to boycott Serb elections and their inclusion as registered voters was assumed to invalidate the vote.

Effective power to govern

Serbia's democratically elected government has the effective power to govern. With the State Union's dissolution, the command of the armed forces was transferred to the Serbian president. The new constitution subjects the military to democratic civilian control exercised by the parliament. However, the EU Commission in its 2006 report noted that parliamentary oversight of the military remained insufficient. The military security services, which had been involved in the assassination of Serbian Prime Minister Zoran Djindjic, were reformed and placed under the direct supervision of a national security council coordinated by the president. The government lacks full control over army and secret service officers who have apparently supported several of the Serb indictees accused for war crimes by the International Criminal for the Former Yugoslavia. The army has been further downsized and conscripts have been gradually replaced with contract officers. The Serbian Military Doctrine has not yet been approved. A new law on the police was adopted in November 2005, but the new law on the security service has not been enacted, hindering further reform in this sector.

Association / assembly rights

The freedoms of association and assembly are constitutionally guaranteed and unrestricted within the basic democratic order. A new law on associations was prepared with wide public consultation, involving the civil society sector and relevant international organizations. However, it was not adopted as of January 2007. A new Law on Churches and Religious Organizations entered into force on 7 May 2006. The law was criticized by the Venice Commission of the Council of Europe for not complying with international standards concerning the registration of religious organizations.

Freedom of expression

The freedoms of opinion and the press are not restricted in principle. Broadcast and print media are characterized by diversified ownership structures, represent different political opinions and provide a largely balanced coverage of the 2007 election campaign. However, associations of independent journalists and media complain about political pressure exerted on media that report on organized crime or war crimes. The Organization for Security and Cooperation in Europe in May

2007 warned that freedom of media was jeopardized by cases of intimidation. An increasing number of journalists have been threatened and attacked during the review period. Several cases of murders of journalists have not been resolved. Electronic media are regulated by the Republican Broadcasting Agency (RBA) that inter alia issues licenses, monitors broadcasters' compliance with general program standards, regulates the program content of the public TV/radio and appoints its managing board. In April 2006, the RBA allocated national frequencies to five television companies through an intransparent decision that was criticized by independent journalists and observers as driven by partisan political motives and violating the public interest. RBA withdrew the license from BK Television, a company established by Bogoljub Karic, a Serbian "oligarch" who had established his own party to compete for political office. Although the Supreme Court annulled the revocation of BK Television's license, RBA prolonged the revocation of the license for an additional 30 days in May. In July 2006, RBA initiated an amendment to the Broadcasting Law that enabled the RBA Council to revoke licenses without delay, thus depriving the affected broadcasters of due legal remedy. The Serbian president opposed these amendments but his decision was over-ruled by parliament in September 2006.In 2006, Radio Television Serbia was transformed into a public service, but the appointment and composition of program boards were criticized for a lack of representativeness and transparency. The legal framework for freedom of the media and of information is still insufficient, lacking rules to prevent media concentration, ensure the transparency of media ownership and protect personal data.

3 | Rule of Law

Separation of powers

The separation of powers has been restricted partially and temporarily in the period between the dissolution of parliament (November 2006) and the first meeting of the newly elected parliament in May 2007. Moreover, the caretaker government in office during this period was not only unaccountable to parliament, but also evaded monitoring by the Constitutional Court or the State Audit Institution. The latter had not been established and the former did not convene during this period because the president of the Constitutional Court, who is exclusively entitled to call its sessions, was not replaced after his retirement in October 2006. Only the president of the Republic continued to fulfill his constitutional role. The parliamentary control of government is generally weakly developed. According to a report by the Open Society Fund, 89% of all laws adopted from 2002 to 2004 originated from government drafts; interpellations and questions were rarely used by deputies, and only two investigative committees were established in 2005; the executive did not submit Serbia's EU accession strategy to parliamentary debate although the parliament had adopted a resolution

obliging the government to obtain parliamentary approval for this strategy. When the defense and foreign affairs portfolios were transferred from the State Union to the republican level, parliament did not approve the creation of the respective ministries, nor did it scrutinize their activities. The new Constitution of Serbia was adopted by parliament in September and approved by referendum in October 2006. The new constitution has established a parliamentary system of government with a president who is directly elected but has only weak appointment and veto powers. The constitution has confirmed the control of political parties over parliamentary mandates, rejecting the notion of an independent mandate established by the Constitutional Court in 2003. In addition, the new constitution endows parliament with the right to elect all judges upon the proposal of the High Judicial Council (HJC), risking a politicization of the judicial profession in particular because the parliament also determines the composition of the HJC majority.

Independent judiciary

The judiciary is established as a distinct profession and operates relatively independently, but its functions are restricted by politicization, corruption, low professional standards and overload. The independence of judges and prosecutors is constrained by the parliament's excessive influence on appointments. The credibility of the judiciary has been damaged by cases of corruption involving high-level judges, for example the president of Serbia's commercial court. Serbian courts are also struggling with a large backlog of cases, leading to long delays in proceedings. The law on the implementation of the new Constitution, adopted in November 2006, envisages that all sitting judges are re-appointed – a provision that has been rejected by the Association of Judges due to its potential for political abuse. The Association has also criticized the lack of precise criteria for the election/dismissal of judges and members of the High Judicial Council (HJC).In May 2006, the government adopted a judicial reform strategy to improve the independence, transparency, accountability and efficiency of courts. The strategy envisaged the creation of an independent budget for the HJC, a transparent election of judges and public prosecutors, a more active role of prosecutors in collecting evidence, the creation of new courts of appeal and new mechanisms to assign cases and schedule trials. However, the strategy kept a controversial probation term for judges and did not establish an effective self-governing structure of the judiciary. Furthermore, the strategy did not guarantee the autonomy of public prosecutors who are appointed for a limited period and have been subject to political pressures.The Criminal Code, the Law on Courts, the Law on Judges and other laws related to the judiciary were amended in 2006. A revised Criminal Procedure Code entered into force in June 2007. It introduced a model of investigation that shifted the leading functions to the police and prosecution, modifying the role of the investigating judge.

Prosecution of office abuse

Corrupt officeholders are prosecuted under established laws, but many slip through political, legal or procedural loopholes. Patronage and clientelism dominate public sector appointments. Having divided ministerial portfolios among themselves, the parties forming the Kostunica government rewarded their rank and file with leading positions in public companies or public administration. A report by the Serbian sociologist Vesna Pesic has documented that the governing Democratic Party of Serbia (DSS), for example, through its control of the Ministry of Education replaced 13 of 14 heads of regional educational departments with loyal DSS supporters. Such clientelist appointment policies ensure governmental control of the administration on the one hand, and serve to fund political parties on the other. A majority of parliamentary deputies perform other commercial, representative and managerial functions generating additional incomes. The conflicts of interest associated with these functions are not effectively monitored and sanctioned by the existing legislation.

Civil rights

Civil rights are violated occasionally and are not fully implemented in Serbia. A skinhead attack against a Roma settlement in February 2006 was not prosecuted through a criminal procedure, although the new Criminal Code (in force since January 2006) defines racism and xenophobia as criminal offences. In March and April 2007, the police shot one alleged Islamic fundamentalist and arrested several other Islamists in the Muslim-dominated Sandzak region because they were suspected of plotting terrorist acts. The Committee for the Prevention of Torture in May 2006 reported cases of ill-treatment by the police, problematic practices of pre-trial detention and unacceptable prison conditions. Pre-trial detainees cannot rely on legally prescribed mandatory defense. Prison facilities and the conditions for medical care of prisoners have been improved. However, the personnel of prisons still lack adequate training, rules of conduct and rules regulating disciplinary procedures. According to the EU Commission report from 2006, around 1000 cases against the former Serbia and Montenegro were pending before the European Court of Human Rights. The first sentence against Serbia was pronounced in September 2006.In April 2007, a Serbian court sentenced four members of the Serbian paramilitary unit Scorpions with imprisonment for the murder of Muslim civilians from Srebrenica. Human rights advocates criticized the verdict as belittling the scope of crimes committed. No senior Serbian military or police officers have hitherto been among those accused of war crimes by Serbian courts, indicating a lack of political will to account for grave human rights violations committed by Serbs. The EU Commission in October 2006 complained that the overall political climate in Serbia would still constrain a fair and transparent conduct of high-profile war crimes trials. The prosecution of war crimes has not been adequately supported and witnesses have not been appropriately protected. A protected witness in the court proceedings against the suspected murderers of Serbian Prime Minister Djindjic was killed in June 2006.The situation of refugees and internally displaced persons from the

Yugoslav wars is still precarious, since the lack of adequate housing inter alia hampers their integration and repatriation. The new constitution contains detailed provisions on human rights and the protection of minorities. It provides a constitutional basis for an ombudsperson and a right of constitutional appeal as a last resort option to protect human and minority rights. The new constitution also envisages ratified international human rights conventions to take direct effect, while stating that international treaties must be compatible with the Serbian Constitution. The new Law on Police was adopted on 14 November 2005 in order to reorganize the police force according to democratic principles. A new police director was appointed, the responsibility of police officers and the treatment of complaints against police behavior have been legally clarified, professional training has been improved and more police officers have been recruited from minority groups. Serbia's government also took several measures to improve education in minority languages. However, the status, work and election of the national councils of minority groups have not been regulated by a law. The scope of functions per-formed by these councils has been disputed between the government and representatives of minority communities.

4 | Stability of Democratic Institutions

Performance of democratic institutions

Democratic institutions perform their functions in principle, but there is still considerable friction between institutions. On the one hand, the legal and constitutional framework of democratic institutions was renewed and further developed in the period between 2005 and 2007. New laws on government, state administration and civil servants were adopted in June and September 2005, laying the ground for a modern system of government and state administration based on the rule of law. A new constitution was adopted by the parliament and approved in a popular referendum in October 2006. While the final draft of the constitution was pushed through parliament without broader public participation and Kosovo Albanian voters were excluded from the referendum, the procedure of adopting the constitution respected the amendment provisions of the old constitution. The new constitution remains ambivalent with respect to the thresholds of constitutional amendment: while it enables the parliament to adopt such amendments with a majority of two thirds of all deputies, large parts of the constitution require a referendum to be amended (inter alia the preamble and principles of the constitution, human and minority rights and freedoms, the vaguely defined "system of authority" and the proclamation of the state of war and emergency). Despite these positive developments, the work of parliament and government has been overshadowed by irregularities and friction. The parties forming the minority government of Vojislav Kostunica retained the government's dwindling parliamentary support by depriving dissenting deputies of their mandates and co-opting opposition deputies with dubious,

unconstitutional methods. The parliament's government-majority Administrative Committee revoked the mandates of governing coalition deputies who had joined the opposition. The oppositional Democratic Party boycotted the work of the parliament between October 2005 and November 2006 in order to protest against the Administrative Committee's decision to prevent the party from replacing the mandates of two Bosniak minority deputies who had been co-opted by the government with loyal deputies. The practices of mandate-stripping contradicted the Constitutional Court's decision of May 2003 that mandates belong to deputies, not to parties. By de facto committing deputies to put their term of office at the disposal of their parties in the new constitution, the parties constitutionalized direct party control over mandates. During the Kostunica government's period of office, the cooperation between the government and opposition president Borislav Tadic did not entail major constitutional conflicts. Tadic used his right of a dilatory veto twice in 2005 and 2006, returning the broadcasting and labor bills to parliament. In both cases, the parliament overruled his veto and adopted the bills without any modification. The new constitution has weakened the president's role in several respects.

Commitment to democratic institutions

Official Serbian institutions, insofar as they claim authority to decide over Kosovo, are not accepted by Kosovo Albanians and their political representatives. Within the Socialist Party of Serbia, there are still political forces that do not accept the legitimacy of Serbia's democratic upheaval in October 2000. The Serbian Radical Party is still committed to its 1996 program of forming a Greater Serbia including Republika Sprska, the Bosnian Serb-dominated entity of Bosnia and Herzegovina, Montenegro and territories of Croatia that constituted ethnic Serb settlement areas prior to the wars. The party's radical rhetoric sometimes raises doubts as to whether it fully supports democratic pluralism.

5 | Political and Social Integration

Party system

Serbia's party system is fundamentally established but still characterized by organizational instability. Parties are moderately polarized, weakly rooted in society and mostly dominated by individual personalities. The period from 2004 to 2006 was characterized by numerous changes in the constellation of parties and their parliamentary groups, which was manifested in continuous horsetrading among parties over the control of parliamentary mandates. One of the junior governing parties, the Serbian Renewal Movement (SPO), split into two parties at the end of 2004. In August 2005, the governing coalition broke up with the Social Democratic Party, which had formed an electoral list with G17Plus and belonged to the parliamentary group of this party. G17Plus left the government in October 2006 due to the government's continued failure to resume negotiations with the European Union over a Stabilization and Association Agreement. The

parliamentary group of the Socialist Party of Serbia, which had provided a parliamentary majority for Kostunica's minority government, collapsed into a reformist group and an orthodox pro-Milosevic wing. In late 2004, a liberal democratic faction split from the parliamentary group of the Democratic Party and established a Liberal Democratic Party (LDP) in November 2005.In the parliamentary elections of 21 January 2007, eleven parties and electoral coalitions entered the parliament. The Serbian Radical Party emerged as the most popular party with 28.6% of the votes and 81 of 250 seats. While the DS won 64 mandates and improved its position compared to the 2003 elections, the DSS and G17Plus lost votes and reached only 47 and 19 mandates. Whereas SPO failed to overcome the five-percent-threshold, a coalition led by the LDP entered parliament (15 seats). SPS remained in parliament with slightly less weight (16 seats). Five parties and coalitions representing national minorities participate in parliament (eight seats) and have formed a minorities' caucus. In sum, the elections enabled pro-European parties to form a majority-based government. The SRS was strengthened but lacked sufficient support to form a government on its own. Electoral volatility has decreased but the party system is still fragmented. The socioeconomic cleavage in the Serbian population has gained importance in the party system, reflecting not only the historic distinctions between a small, educated urban middle class, larger traditional rural groups and the industrial workforce, but also the emerging gap between winners and losers of recent economic reforms. In contrast, the SRS and SPS as parties associated with the Milosevic regime have become less clearly opposed to parties associated with the democratic opposition movement against Milosevic, indicating a weakening of the authoritarian-democratic cleavage. A third main cleavage structuring the party system is socio-cultural and concerns issues of state and national identity.

Interest groups

The network of interest groups is relatively close-knit. Business interests are still dominated by a few oligarchs with dubiously generated assets, and by old-style managers of loss-making publicly owned companies and their problematic or illegal lobbying practices. Trade unions have little influence and are best organized in the still-unreformed state sector. According to an opinion poll conducted by Center for Free Elections and Democracy in September 2005, only 3% of Serbian citizens actively participated in trade unions.

Consent to democratic norms

Consent to democracy as a set of norms is moderate to high, and political protests do not question the constitutional framework. However, trust in democratic institutions is very low. A representative opinion survey conducted by the Serbian sociologist Vesna Pesic in July 2006 showed that only 8% of the population believed the parliament to be serving the interest of citizens and only 11% perceived the government as serving citizens' interests.

Associational activities

Civil society organizations are well developed, numerous and active in Serbia, but civic self-organization is limited by legal, financial and cultural barriers. In

2006, there were approximately 25,000 NGOs in Serbia and Montenegro, a majority of which were sports associations. Their legal situation is difficult because the envisaged law on associations has not been adopted. Many NGOs depend on foreign donations, which exposes them to critique from nationalist and extremist groups. NGOs that address war crimes or past injustices have faced public criticism, threats and intimidation. Despite the relatively large number of NGOs, only few citizens have expressed confidence in NGOs and even fewer participate actively.

II. Market Economy

6 | Level of Socioeconomic Development

Socioeconomic barriers

With a gross national income of $3,280 per capita in 2005 (at current exchange rates), Serbia belongs to the lower-middle income countries of the world and ranks lower than Croatia and Bulgaria, but higher than Macedonia or Bosnia and Herzegovina. Social exclusion is quantitatively and qualitatively limited and not very structurally ingrained. Household surveys from 2002/03 indicate that 10.5% of the population lived below the national poverty line of 4,970 Dinars ($87) per month. Serbia's absolute poverty rate (the share of persons living from less than $2 per day) is similar to the rate of Romania, lower than in Albania and higher than in Bulgaria and Poland. In 2005/06, net average earnings grew strongly in nominal and real terms. The official rate of registered unemployment increased to 33.2% in 2006, combined with high shares of longterm and youth unemployment. According to estimates, the informal sector comprises approximately one third of employment. Important regional disparities exist both in employment and unemployment.

Economic indicators		2002	2003	2004	**2005**
GDP	$ mn.	15,528	20,666	24,353	**26,215**
Growth of GDP	%	4.3	2.4	8.8	**4.7**
Inflation (CPI)	%	-	-	-	**-**
Unemployment	%	13.8	15.2	-	**-**

		2002	2003	2004	**2005**
Foreign direct investment	% of GDP	0.9	6.6	4.0	**5.7**
Export growth	%	11.6	7.3	38.2	**10**
Import growth	%	25.6	7.9	38.1	**-4**
Current account balance	$ mn.	-	-	-	**-**
Public debt	$ mn.	7,814.9	8,475.1	8,519.7	**7,972.1**
External debt	$ mn.	11,559.6	14,374.1	14,717.5	**16,294.5**
External debt service	% of GNI	1.6	2	3.8	**4.9**
Cash surplus or deficit	% of GDP	-3.0	-	-	**-**
Tax Revenue	% of GDP	23	-	-	**-**
Government consumption	% of GDP	18.5	18.2	17.9	**18.1**
Public expnd. on edu.	% of GDP	-	-	-	**-**
Public expnd. on health	% of GDP	5.9	6.9	7.3	**-**
R&D expenditure	% of GDP	1.2	-	-	**-**
Military expenditure	% of GDP	4.4	3.5	3.4	**2.6**

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security. All data for Serbia and Montenegro.

7 | Organization of the Market and Competition

Market-based competition

Serbia has since 2000 established an institutional framework of market competition, but the scope of the informal and state sectors remains substantial. The government hesitated to initiate bankruptcy proceedings against loss-making state- and socially owned enterprises, as it feared further increases in unemployment and social unrest. Plans to launch a public investment program and to cut labor taxes in 2006 were criticized by the international financial institutions for their fiscal consequences. The business environment has improved, but is still constrained by legal uncertainty, rampant corruption and red tape. The government continued to intervene directly in economic activities throughout the review period. For example, it directly revoked the license of the mobile phone operator Mobtel in December 2005, while ignoring the regulatory competence of the telecommunication agency. Serbia's new constitution explicitly defines its economic order as a market economy. New laws on Takeover of Joint-stock Companies and on Accounting and Auditing entered into

force in June 2006. The laws regulate the equal treatment of shareholders and the compliance of financial statements with international accounting standards. New company registers have been established since August 2005.

Anti-monopoly policy

In September 2005, Serbia adopted a Law on the Protection of Competition, introducing for the first time a legal framework to regulate the formation and activities of monopolies and cartels. In May 2006, a competition agency was established to enforce the law.

Liberalization of foreign trade

Foreign trade is liberalized in principle, but significant exceptions remain, including differentiated tariffs and special rules for individual sectors. The weighted average tariff rate was, according to a report by the International Monetary Fund (IMF), 7% in 2006. Tariff structures have been relatively stable, and no quotas have been applied – such that world and domestic relative prices for tradable goods are largely aligned. Licenses are required for sensitive products, domestic agriculture continues to be protected, and refined oil products may not be imported in order to protect domestic oil refineries. In 2005, exports and imports to and from the European Union comprised 56 and 49% of total exports and imports respectively. Serbia joined the renewed Central European Free Trade Agreement in December 2006. The Agreement integrates the bilateral free trade agreements among Southeast European countries and enables a diagonal cumulation of origins in order to facilitate intra-regional trade. Serbia had not joined the World Trade Organization by January 2007. According to the European Bank for Reconstruction and Development (EBRD), the prices of approximately 9% of the goods included in the consumer price index were still administered in 2005.

Banking system

The banking system and capital market are differentiated and oriented in principle to international standards, but their dependence on exchange rate fluctuations and insufficient supervision render them vulnerable. In 2006, foreign banks owned about 77% of assets in the banking sector. On the background of strong credit growth, the share of non-performing loans rose quickly and comprised, according to the IMF, 20.7% of total lending in March 2006. Since most credits are effectively denominated in foreign currency, private credit holders incur the cost of foreign exchange rate changes. The high share of Euro-based transactions has limited the capacity of the central bank to restrict Serbia’s credit boom by depreciating national currencies, since depreciation would engender an impoverishment of many citizens with Euro debts. To avoid a destabilization of the banking system, the central bank has inter alia increased the minimum capital adequacy ratio for banks. A new banking law, aligning domestic regulations with international standards, entered into force on 1 October 2006. The parliament adopted a law on investment funds and amendments to the law on security markets and other financial instruments in May 2006. Stock market capitalization increased to 24% of GDP in 2005 (EBRD figure). The central bank tightened

minimum capital requirements and enforced solvency requirements for insurance companies.

8 | Currency and Price Stability

Anti-inflation / forex policy

Controlling inflation and an appropriate foreign exchange policy are recognized goals of economic policy, but have not been consistent over time. Inflation was successfully reduced to single-digit levels at the end of 2006, but continued to be supported by strong domestic demand, increases in administered prices, lack of competition in domestic markets and widespread exchange rate indexation of prices. The central bank has begun to introduce inflation targeting. Serbia's exchange rate regime is a managed float. In July 2006, a new Law on Foreign Exchange Operations was adopted in order to further liberalize the movement of capital. The governor of the central bank has been concerned over the weakening of the bank's independence, because the Law on the Implementation of the New Constitution envisaged the re-election of the bank's governor and the members of its managing board.

Macrostability

There is a general commitment to stability, supported by Serbia's dependence on the International Monetary Fund, but fiscal consolidation policies were weakened in 2006. One IMF concern has been the government's intended public investments of € 1.6 billion from the privatization proceeds received in 2006. The ratio of external debt to GDP was over 60% in 2006 (EBRD figure), despite the debt reduction agreed with the Paris and London clubs, and the ratio has risen again, following several years of decline.The consolidated general government budget reached a surplus of 2.7% of GDP in 2006 due to large privatization revenues. Whereas VAT revenues declined, personal and corporate income tax revenues increased. Expenditures also grew, mainly due to wage and salary increases.

9 | Private Property

Property rights

Property rights and the regulation of the acquisition of property are well defined in principle, but there are problems with their implementation. Laws on mortgages and arbitration were adopted in December 2005 and May 2006. The new constitution allows foreign citizens to obtain real estate property, but the tradability of agricultural land is restricted. A law on the restitution of property of churches and religious communities entered into force in October 2006, envisaging the return of nationalized property to their previous owners or, where this is impossible, their compensation. As of January 2007, the envisaged law on the restitution of other property had not yet been adopted.

Private enterprise

Private companies produced 55% of Serbia's GDP in 2006, but state- and socially owned companies still comprise a large share of the economy. Oligopolies are tolerated by the state. In 2005, the laws on privatization, share fund and financial markets were amended in order to speed up privatization. However, several large socially owned enterprises have not been restructured, partly due to the financial and social implications of closures. These also include utilities such as NIS (oil), EPS (electricity) and Telekom Srbije. The sale of the Bor copper mining and smelting enterprise failed and was overshadowed by allegations of corruption. Over-employment and weak corporate governance plague companies such as the car manufacturer Zastava and the airline JAT. According to an IMF report, the losses of non-private enterprises exceeded their profits by 5.3% in 2005.

10 | Welfare Regime

Social safety nets

Although social safety nets do not cover all risks for all strata of the population, poverty is confined to groups affected by unemployment, lack of education and forced migration during the Yugoslav wars. Roma are particularly disadvantaged. Social assistance, pension, unemployment and health insurance schemes compensate for broad social disparities, but these schemes are limited in scope and quality. Access to the family allowance scheme has been widened in order to improve poverty prevention. The 2005 Labor Law raised severance payments, non-wage benefits and experience pay, as well as added further steps to lay-off procedures, and set a 12-month non-renewable limit on fixed-term appointments. A law on voluntary pension funds and plans, adopted in September 2005, established an additional funded tier of the pension system. In November 2005, new laws on health insurance and health care were adopted. The health care reform sought to better define the health rights of citizens and patients, strengthen the gate-keeping function of general practitioners, decentralize management and increase the productivity and quality of care.

Equal opportunity

There are a number of institutions to compensate for gross social differences. A new law on the prevention of discrimination of disabled persons was adopted in April 2006. Non-discrimination provisions in the labor code were expanded. An anti-discrimination law has been prepared, and the government has adopted several action plans to improve the situation of Roma. However, Roma still face considerable discrimination on the labor market and in the education system.

11 | Economic Performance

Output strength

The real GDP of Serbia (excluding Kosovo) has, according to an EBRD report, grown by annual average of 5.5% since the end of the Kosovo war. Serbia's inflation rate decreased to 6.6% at the end of 2006. Official unemployment has

risen continually; it is approximately 33% of the labor force, but surveys indicate that the real unemployment rate is lower due to the informal sector. Serbia's current account deficit amounted to approximately 12.9% of GDP in 2006, caused by high capital inflows, strong domestic demand and a relatively weak export performance due to the lack of a competitive domestic production. Foreign direct investments amounted to approximately $4.4 billion in 2006, predominantly related to privatization in the financial sector, and the construction and processing industries. Investment ratios remained clearly below those in other transition countries.

12 | Sustainability

Environmental policy

Environmental concerns tend to be subordinated to growth efforts. Serbia has begun to align its legislation with the European Union's environmental regulations. A Fund for Environmental Protection was set up in 2005 to support the development of pro-grams, projects and other activities in the fields of environmental protection and energy efficiency, including renewable energy.

Education policy / R&D

Both state and private institutions for education, training and research and development are strong and in some cases quite advanced. According to data provided by the Serbian Ministry of Finance, public spending on education amounted to 4% of GDP in 2005/06. Government expenditure on research and development accounted for about 0.25% of GDP in 2005. To align higher education programs with the Bologna process, a new Law on Higher Education was adopted in August 2005. A new Law on Science was adopted in December 2005.

Transformation Management

I. Level of Difficulty

Structural constraints

The structural constraints on governance are moderate. On the one hand, unresolved statehood problems and the economic, social and political legacies of the Yugoslav wars have burdened Serbia's path to democracy and market economy. On the other hand, Serbia's population is relatively well educated and the country's level of economic development has traditionally been relatively high. Ethnic diversity in Serbia proper and negative effects of the semi-authoritarian Milosevic period such as a distorted, uncompetitive economic structure and widespread corruption pose additional difficulties for the political leadership.

Civil society traditions

Traditions of civil society can be considered moderately strong, initially due to the fact that Yugoslavia's socialist system conceded niches for a small segment of urban intellectuals and subsequently because the opposition protests against the Milosevic regime in the course of the 1990s turned into a broad popular movement involving and mobilizing many citizens beyond the urban intellectual cores of civil society. Numerous civil society organizations have persisted from this period and contribute to public accountability.

Conflict intensity

Society and the political elite are polarized along ethnic issues such as Kosovo, Montenegro, Vojvodina, ethnic Serbs in Bosnia or Croatia, but also increasingly social issues (wages, public services, living conditions, corruption). Radical political actors have continued mobilizing for ethnopolitical issues. For example, radical groups have formed an exiled government of Srpska Krajina to advocate for the annexation of ethnic Serb settlement areas in Croatia, and a "Tsar Lazar" guard to reconquer Kosovo after its declaration of independence.

II. Management Performance

In the period between 2005 and January 2007, two governments led by Prime Minister Vojislav Kostunica governed Serbia. Both cabinets lacked a stable

majority in parliament and had to rely on support from the Socialist Party of Serbia and in some cases from other opposition parties as well. The first Kostunica cabinet was formed by the Democratic Party of Serbia, the G17Plus party of economic reformers, the Serbian Renewal Movement and the New Serbia party. On 1 October 2006, the second largest party of the governing coalition, the G17Plus, left the government and its ministers (deputy prime minister and ministers of finance, agriculture and health) resigned.

14 | Steering Capability

Prioritization

In the period between 2005 and January 2007, Serbia's political leadership sought to build democracy and a market economy, but often postponed long-term aims in favor of short-term political benefits. Most importantly, the Kostunica governments did not take determined steps to locate and arrest those persons who were accused of war crimes by the International Criminal Tribunal for the Former Yugoslavia (ICTY), although evidence provided by the ICTY showed that the government knew where some of the indictees resided. The government's failure to seize and extradite the former Bosnian Serb wartime military commander Mladic caused the European Union to suspend negotiations on a Stabilization and Association Agreement in May 2006. This failing was perhaps required to sustain parliamentary support for Kostunica's minority governments and also heeded popular resentment against the ICTY. However, it delayed the European integration of Serbia and the numerous, substantial economic and political benefits EU membership would have generated for Serbia. Serbia's political leadership also invested considerable efforts in preserving Kosovo as a part of Serbia, although a Kosovo with an impoverished population refusing Serbian sovereignty entailed a burden for democracy and market economy rather than an advantage.

Implementation

Both Kostunica governments were committed to democracy and a market economy, but their unstable parliamentary majority delayed implementation of reforms. The government successfully managed the peaceful dissolution of the State Union with Montenegro and settled issues arising from the state succession. Furthermore, despite its uncertain parliamentary majority, the Kostunica government achieved the adoption of a new constitution in September/October 2006, 53 laws in 2006 and 122 laws in 2005. While these high numbers indicate intense legislative activity, their implementation still poses a challenge. Nevertheless, numerous complex policy reforms were initiated at the same time, including education, health care, judiciary, public administration and pension reform. Implementation gaps persist regarding anti-corruption measures, judicial reform and the restructuring of major state-owned enterprises and utilities.

Policy learning

Serbia's reformers have quickly adapted their economic reform policies and sought to learn from international experience and advice. However, the government has also taken a rigid position in the process of Kosovo status negotiations. The Serbian negotiating platform from January 2006 essentially envisaged "more than autonomy, less than independence" for Kosovo. It insisted upon the preservation of Serbian integrity and sovereignty, although the proposed territorial autonomy for Kosovo was categorically rejected by Kosovo Albanians and not supported by Martti Ahtisaari, the U.N. Special Envoy who mediated the status talks.

15 | Resource Efficiency

Efficient use of assets

The Kostunica governments have improved the efficient use of resources in some respects, but have failed to prevent corruption, political patronage and nepotism. According to a report by the Open Society Fund, the total number of public employees (without municipal and provincial self-government employees) decreased from 192,611 (2004) to 186,547 in 2006. A new Law on Civil Servants entered into force in July 2006. The law defines the scope of the civil service and differentiates between political appointees and civil servants. It contains unified principles guiding the civil service, including equal access, the rule of law, neutrality, performance assessment, professionalism, merit-based recruitment and promotion. These principles were intended to foster the de-politicization and continuity of the civil service. Following this reform, the payment system for civil servants has been restructured in order to improve the remuneration and performance orientation of civil servants. A new law on local government financing, adopted in July 2006, allows for greater fiscal decentralization. Municipalities have been tasked with the collection and administration of local taxes, capital investments in primary healthcare and the organization of transport for pre-school children. However, new arrangements for financing these responsibilities through general and specific grants had not been developed as of January 2007. A treasury single-account system was established in 2003 to manage the execution of the state budget, the financial plans of the extra-budgetary funds and the budgets of local self-government units. The system has significantly improved the transparency of the budget process. The collection of tax revenues has, however, been constrained by weak administrative capacity, particularly regarding the control of VAT and excise duties. In November 2005, Serbia adopted a Law on a State Audit Institution. The audit agency had not been established as of January 2007, although the legal deadline for appointing its executive board was May 2006.

Policy coordination

The Kostunica governments faced increasing difficulties in coordinating between conflicting objectives and interests as its supporting parties became

more fragmented over the course of 2005 and 2006. In contrast with the greater extent of collective decision-making in the cabinets of Prime Ministers Djindjic and Zivkovic, Kostunica's first cabinet essentially operated as two semi-separate entities, one led by the prime minister, the other by the deputy prime minister and G17Plus politician Miroljub Labus, with each controlling the ministries affiliated with their respective parties. Political issues were discussed and solved in informal meetings of the party and government leadership rather than in cabinet meetings. Conflicts over the policy dealing with indictees of the ICTY prompted Labus to resign in May 2006.In 2005, the legal basis for the work of the government and its commissions was strengthened by the adoption of a new Law on Government and new Rules of Procedure. While the general secretariat of the government has been legally codified and its powers have been expanded, its role is still essentially limited to administrative rather than policy-oriented coordination.

Anti-corruption policy

Most integrity mechanisms are functioning with limited effectiveness. Between 2004 and January 2007, the government did not undertake decisive steps to improve existing and create missing integrity mechanisms. In December 2005, the government adopted a national strategy for fighting corruption. No action plan for the implementation of the strategy was adopted, and no anti-corruption agency had been established by January 2007. The role of the anti-corruption council, established in 2001, has been unclear and weakened due to the resignation of some of its members. Few cases of corruption have been prosecuted. The state audit institution was not yet established as of January 2007. The EU Commission deemed institutional independence and administrative capacity of the public procurement office insufficient. The existing law on conflict of interests lacks effective monitoring and sanctioning mechanisms and does not encompass many public functions exposed to corruption. According to an EU Commission report from 2006, around 40% of public officials did not report on their assets and income. The law on the financing of political parties has not been adequately implemented. Parties frequently ignore the law's provision to disclose the names of their donors, and in 2005, most parties did not submit complete annual financial and activity reports on time to parliament's financial board.

16 | Consensus-Building

Consensus on goals

There is a basic consensus about democracy and market economy among Serbia's current political leadership. All parliamentary parties arrived at an agreement on the new constitution in September 2006, ensuring its nearly unanimous adoption. The political leadership also succeeded in obtaining a popular majority for the new constitution in the ensuing referendum. While the

Serbian Radical Party (SRS) still adheres to its Greater Serbia program, its leaders have tacitly moved away from its president, indicted war criminal Vojislav Seselj, who is detained in The Hague. Both SRS and the Socialist Party of Serbia have undergone a process of change and re-orientation that could bring them closer to the values and institutions of Serbia's post-Milosevic democracy. However, the outcomes of these internal changes were not clear in January 2007. While SRS was reconfirmed as the most popular party in the elections of 21 January 2007, the elections also produced a majority of parties committed to liberal democracy and Western market economy, thus strengthening the basic consensus on these aims.

Anti-democratic veto actors

In the period under consideration, the Kostunica governments further restricted the influence of those elements in the army, security services and police that had challenged Serbia's post-2000 democratic institutions by assassinating its prime minister.

Cleavage / conflict management

Serbia's political leadership did not make many efforts to reduce existing divisions or prevent the escalation of conflicts based on ethnic and national cleavages. In the U.N.-mediated negotiations on the future status of Kosovo, the Serbian delegation insisted on its proposal of a territorial autonomy and refused to accept the Kosovo Albanian demand for independence. While the failure of the status negotiations must also be attributed to the intransigency of the Kosovo Albanian leadership, the focus here is on the political leadership in Belgrade and its relationship to what it considers citizens and territory of Serbia. The official Serbian position is derived from a historically justified territorial claim, lacking any reflection over what could constitute national interests in an age of European integration, diminishing borders and growing international interdependency. Within Serbia proper, the political leadership has sought to integrate the remaining national minorities. In addition, Serbia's political leadership refrained from mobilizing and instigating the sizeable ethnic Serb community in Montenegro during the independence process, marking a stark contrast to the Milosevic regime.

Civil society participation

The political leadership has sought to take the civil sector into account, most notably in preparing the poverty reduction strategy and in communicating the government's EU accession policy. Under the Law on Free Access to Public Information, parliament and ministries have started publishing information bulletins. A commissioner for public information has been established to advocate for the concerns and protect the rights of citizens. Civil society organizations were allowed to attend sessions of parliament. However, civil society organizations were excluded from the final drafting of the constitution and their role in democratic society is still insufficiently understood by parts of the state administration.

Reconciliation

Serbia's political leadership has not yet fully addressed the republic's responsibility in the wars of the nineties. Serbia's president, Boris Tadic, has suggested the adoption of a parliamentary declaration unequivocally condemning the crime committed in Srebrenica, but the initiative did not receive sufficient support in parliament. According to a Council of Europe report in 2007, "no real general societal effort can yet be seen of facing the crimes committed by the Milosevic regime." Self-critical accounts of Serbia's role in the Yugoslav wars remain confined to a narrow segment of urban intellectuals. Cooperation with the ICTY is largely driven by the conditionality of external aid and EU accession, not by a broad-based domestic recognition of the necessity of coming to terms with the past. According to an opinion poll conducted in 2006, 38.7% of the respondents were "absolutely against" the transfer of Mladic to ICTY. When Milosevic died on 11 March 2006 in a prison cell of ICTY, allegations were raised as to whether he was poisoned, questioning the role of the Hague tribunal. In June 2005, Serbian TV broadcast a videotape showing the execution of Muslim prisoners by a Serb paramilitary unit during the Bosnian war. The pictures made many Serbs suddenly aware of the crimes committed in the name of their country. However, several members of this paramilitary unit received only light sentences by a Serbian court, revealing the difficulties of Serbia's judiciary in addressing past war crimes.

17 | International Cooperation

Effective use of support

Serbia's governments have worked with international donors and effectively used international assistance for most items of their domestic reform agenda. Technical assistance was inter alia used to reform public administration, the judiciary and various areas of economic reform. International advice has only reluctantly been accepted on issues related to perceived key national interests, notably Kosovo and cooperation with the ICTY.

Credibility

The Kostunica government has tried assure its international partners of its credibility and reliability, but major international actors have raised doubts regarding its political will to comply with their expectations. The government did not fully cooperate with the ICTY which has been a crucial precondition posed by the Europan Union for a closer relationship with Serbia. While Serbia's political leaders have officially declared their willingness to cooperate with the Tribunal, they did not make a determined effort to locate, arrest and transfer the indicted war criminals prosecuted by the Tribunal. The IMF criticized that the government's public investment program launched in 2006 would question its commitment to macroeconomic stability. The Council of Europe's Venice Commission has warned that Articles 16 and 194 of the new constitution might jeopardize Serbia's international liability, as they require ratified international

treaties to comply with the constitution. These provisions would enable the Constitutional Court to put ratified international treaties out of force if they violate the constitution, forcing Serbia either to amend the constitution or withdraw from the treaty. Serbia has demonstrated its international credibility by complying with the Dayton Peace Agreement for Bosnia and Herzegovina. Serbian political actors have refrained from publicly supporting the Bosnian Serb calls for a right of secession in case of Kosovo's independence. The State Union with Montenegro was dissolved through mutual cooperation and in accordance with the State Union Constitutional Charter.

Regional cooperation

Apart from Kosovo and ICTY, Serbia's political leadership has cooperated with neighboring states and complied with the rules set by regional and international organizations.Serbia has actively participated in regional cooperation initiatives such as the Stability Pact, the South East Europe Cooperation Process, the Central European Initiative and the Black Sea Economic Cooperation. Serbia signed the Central European Free Trade Agreement, the Energy Community Treaty and the European Common Aviation Area Agreement in 2006. On 29 November 2006, Serbia joined NATO's Partnership for Peace. Serbia recognized Montenegro as an independent state in June 2006 and quickly established diplomatic relations with Montenegro. In November 2005, the Serbian prime minister visited Croatia for the first time since 1991, indicating an improvement of bilateral relations. Serbia has complied with the Dayton Agreement and maintained good neighborly relations with Bosnia and Herzegovina. Cooperation with Republika Srpska was intensified by signing a new Agreement on Special Parallel Relations, in line with the Dayton Agreement.

Strategic Outlook

Political and economic challenges continue to obstruct Serbia's path to a consolidated democracy and market economy. The proposal for the Kosovo Status Settlement, prepared by U.N. Special Envoy Marti Ahtisaari in February 2007, sets out an internationally supervised independence for Kosovo. As viable alternatives to this option are unlikely to emerge in further negotiations, Serbia's political leadership should be ready to accept a decision to establish an independent Kosovo and they should communicate this decision to their public and citizens. Losing territory may be tragic for those who associate control over this territory with national pride and identity; however, Serbian citizens will benefit from consolidated democracy, socioeconomic development and European integration – objectives that will be difficult to reach with an underdeveloped and unruly Kosovo.

The pro-European parties that have formed the government after the elections of January 2007 have a unique chance to organize their agenda according to priorities serving the long-term interest of the country and its citizens. Based upon the new constitution, Serbia's newly elected government and parliament will have to continue reforming the state institutions in order to prepare the country for EU membership. These reforms include in particular establishing an impartial, professional and efficient judiciary and public administration, as well as integrity mechanisms preventing corruption. In other Southeast European candidate countries, these reforms have proven particularly difficult – but experiences from neighboring states certainly also provide important lessons for reformers in Serbia, helping them to eschew the mistakes made by more advanced transition countries.

The major challenge of economic reform is to restructure the remaining state-owned and socially owned enterprises. The government will have to either liquidate them and sell their assets or attract strategic investors who will modernize their outdated capital stock. Both strategies of restructuring will entail mass lay-offs that can only be absorbed if the private sector is developing dynamically enough to generate a sufficient number of new jobs. Private sector growth should be driven both by more foreign greenfield investment and by the spread and maturing of domestic business. This will require not only macroeconomic and regulatory stability, but also political confidence and a business-friendly environment.

External supporters should recognize the main risk for Serbia's development: the socioeconomic costs of restructuring in combination with popular frustration

over an independent Kosovo may lead to political protest and radicalization. Firstly, the international community should address this risk through decisive action in Kosovo. Robust and coordinated diplomatic and political action backed by military commitments would demonstrate to nationalist political elites in Serbia that violating international settlements and attempts to unilaterally change the territorial status quo will be associated with unacceptable costs.

Secondly, international organizations and agencies should ensure that cooperative behavior and economic reforms yield tangible benefits for large parts of the population. The European Union should upgrade its relations with Serbia by concluding a Stabilization and Association Agreement in 2008. While the agreement on visa facilitation and readmission was an important first step to support the domestic reformers, the European Union should reinforce the credibility of Serbia's prospects of membership by delineating a clear, mutually binding roadmap for accession.

Thirdly, the European Union and other Western states and organizations should continue to provide financial assistance. Visible, large investments in transport, communication and environmental infrastructure would display to Serbia's citizens the benefits of reforms and cooperation. Western assistance should also focus on improving the quality of Serbia's judiciary, police and public administration. The country needs a civil service that is protected against corruption and politicization and committed to the highest standards of professionalism. Serbia also needs a competitive private sector in order to sustain its current growth, catch up with the rest of Europe and utilize the advantages of Europe's internal market.